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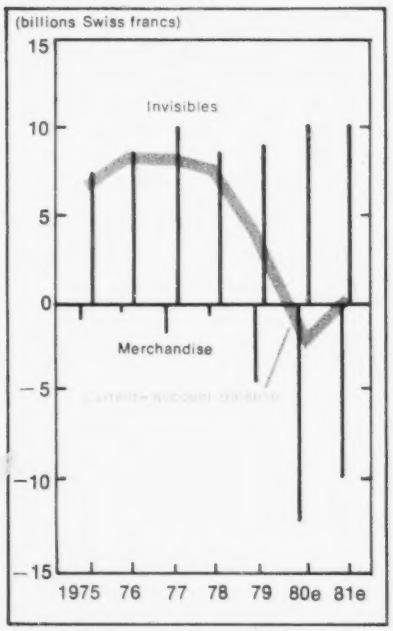
A Turnaround for the Swiss Current Account

Switzerland will register its first current-account balance-of-payments deficit since 1965 this year. Although the traditional net surplus on the invisibles account is growing, the Swiss trade balance has deteriorated sharply. The causes are twofold: a negative swing in the Swiss terms of trade and the relative buoyancy of the domestic economy.

The trade deficit piled up in the first nine months of 1980 exceeded 9 billion Swiss francs, compared with a shortfall of SF 3.3 billion in the January-September 1979 period. Imports are running some 29% above their year-earlier level, owing to a 25% increase in prices. Oil is not the only culprit, however, as crude oil imports are equivalent to less than 11% of total merchandise imports. More important has been the strength of domestic economic activity, which has led to a large increase in raw material and capital goods imports. Thus, despite a strong performance by an export sector still recovering from the Swiss franc's appreciation in late 1978, the trade balance is likely to be 12 billion francs in the red this year. By comparison, the trade-account shortfall was only SF 520 million in 1978 and SF 4.7 billion last year.

Swiss external account balances



Switzerland's perennial invisibles surplus is expected to widen this year. Earnings from interest, profits, and dividends from overseas investment will total more than 7 billion francs this year, and tourist receipts will add another SF 2 billion. Both invisibles categories will post higher earnings this year than in 1979, particularly income from tourism, which has bounced back from its depressed levels in the late 1970s. With an invisibles surplus projected at some SF 10 billion in 1980, the current account will shift into a deficit of approximately SF 2 billion. This represents a net deterioration of more than 10 billion francs on an annual basis from the surpluses recorded in both 1976 and 1977. Last year, the surplus on current account was slightly more than SF 4 billion.

Some improvement in the Swiss overseas trade performance is foreseen for 1981. If oil prices do not rise by much more than 20% through 1981, the total import bill may not increase greatly as import volume is expected to be reduced substantially because of the domestic economic slowdown likely in the first part of 1981. Nonetheless, export volume is already falling off as recession deepens in the economies of Switzerland's major trading partners—especially Germany. Consequently, a marginal reduction in the trade deficit, combined with continued buoyancy of invisibles earnings, may put Switzerland's 1981 overall current account in rough balance.

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U.K. interest-rate reduction feared to be premature.

The U.K. recession has evolved into the worst economic slump since World War II. Official forecasts have been revised downward once again; the current expectation is that GDP will decline by about 3% in 1980 and by another 1½% in 1981. On the positive side, the balance of payments is expected to register a large surplus both this year and next, while the rate of inflation will continue its decline through 1981, falling to an officially estimated annual rate of 11% by the fourth quarter of next year. Despite the economic weakness, the British Chancellor's recent statement to parliament reaffirmed the government's long-term commitment to a policy of domestic restrictiveness. The budget for fiscal 1981/82 calls for additional, and sharp, cuts in public spending, an £800-million reduction in borrowing by nationalized industries, an additional 20% tax on oil company revenues, an increase in national insurance contributions, and less than full indexation of pensions and other benefits. Curiously—and significantly—the authorities have also cut the Bank of England's minimum lending rate (MLR) to 14% from 16%. When the MLR was cut to 16% from 17% in July, the government argued that the monetary statistics would soon justify the reduction. But subsequent sterling M_3 money supply developments pointed to the maintenance of at least a 17% rate. Thus, cutting the MLR to 14% is a gamble based on the assumption that the recent rapid growth in the M_3 money supply will ease. If the government proves correct, interest rates will follow a steady downward path. But if the authorities are wrong, doubts about the MLR cut will increase, as will suspicion that a significant loosening of monetary policy is being pursued. This could lead to a reassessment of economic prospects and may trigger higher wage settlements, which in turn would keep interest rates from falling—possibly even boosting them higher.

Israeli inflation rate accelerating, but trade accounts have improved.

The Israeli economy remains plagued by high inflation. Deflationary measures adopted last fall secured some reduction in the pace of inflation during the first half of 1980. But a pick-up in economic activity around midyear led to a fresh round of 8%-10% monthly hikes in the consumer price index. The rate of inflation is now expected to reach 160% on an annual basis by yearend, despite real 1980 GDP growth projected at only 1.5%. Political pressure is mounting for the Likud government to reduce inflationary pressures. But a Bank of Israel proposal to seek a wage-price accord was thwarted by the Histadrut (the labor federation). In addition, new initiatives to stem government spending—which led to Ezer Weizmann's resignation from his defense post in the Begin cabinet— are currently bogged down. A positive element in the economic sphere, however, is Israel's improved trade performance. The January-September trade deficit amounted to $1.9 billion, slightly less than the shortfall recorded in the year-earlier period. The trade accounts have been buoyed by strong export growth and weak import volume growth attributed to the domestic economic slump.

Brazil modifies its indexation system to boost savings and exports.

Brazil has liberalized its system of comprehensive indexing of financial instruments and the cruzeiro exchange rate. Savers and exporters had argued that the previous ceiling on indexation failed to compensate for the 100% inflation experienced in the latter part of this year. Under the new guidelines, monetary correction will be keyed to a national consumer price index, and the exchange rate will be devalued in accordance with the differential between internal and external inflation. If these policy changes achieve their purpose, they should boost domestic savings by making financial instruments more attractive and increase foreign-exchange earnings by making exports more competitive. These would help curb Brazil's external finance requirements. Brazil has already managed to obtain the needed finance for 1980 through a considerable gain in export earnings, external borrowings, and via drawdowns of international reserves. The increased incentives engendered by the new indexation system should help Brazil satisfy its financing needs in 1981.

Jamaica looking to the IMF for aid in easing foreign-exchange crunch.

The most serious problem facing Jamaica's new president Edward Seaga is a severe foreign-exchange shortage. The country's international reserves are negligible, and its net foreign asset position is more than $800 million in the red. Moreover, Jamaica's external debt totals $1.8 billion, equal to about 60% of GDP. Critical to easing the foreign-exchange crunch is financing from the IMF, with whom negotiations were broken off last March. Jamaica is anticipating funds of up to $570 million from the IMF over the next three years, the maximum entitlement under the extended facility arrangement. After repayments due, however, net new lending by the IMF will come to only $250 million. Consequently, the authorities are also counting on rescheduling some $825 million owed to international commercial banks and the Paris Club. At the same time, they are looking to the Venezuelan/Mexican oil rebate facility to provide credit of up to $100 million next year and are soliciting other sources of bilateral and multilateral assistance.

Argentine tax changes boost inflation but should have positive long-term results.

After declining steadily throughout most of the year, Argentina's inflation rate spurted upward in October. The consumer price index rose 7.6%, with wholesale prices advancing 5.5%. This compares with a September increase of 4.5% in consumer prices and 2.8% in wholesale prices. The consumer price jump in October brought the annualized inflation increase to nearly 90% from 84% in September, reversing the downward trend that had seen the annualized rate decline from 140% in December 1979. The October spurt was the result of recent major changes in the Argentine tax system. The value-added tax has been boosted and extended to cover a larger number of goods and services. At the same time, a number of business taxes and social security charges have been either lowered or eliminated to assist firms squeezed between a slowly depreciating currency and rising domestic costs. Although the tax modifications will boost the price level in the near term, improved earnings should materialize for exporters and import-competing businesses caught in the inflation-devaluation bind.

Philippine government taking concrete measures to reduce oil-import dependence.

The Philippines is one of the few oil-importing developing countries to be following a coherent energy program aimed at lessening oil-import dependence. Recent price increases will swell the oil import bill to $2.4 billion this year, 40% of export earnings. Consequently, the government is banking on an expansion of domestic output that will reduce the percentage of total energy needs satisfied by imported oil to about 41%. In addition, the government has shortened the time span in which the energy program targets are to be achieved from ten to five years. The accelerated program envisages cutting the percentage of oil in total energy usage from 93% in 1979 to 55% by 1985. Use of coal, hydroelectric, nuclear, geothermal power, and non-conventional sources such as alcogas are also set to expand. The cost of the five-year energy program is estimated at $9.5 billion, about half of which will be in foreign exchange. Considering other demands on the Philippines' financial resources, it is possible that the targets will be missed by one year or so. Still, the authorities appear determined, and the program seems technically sound and enjoys the support of international lending institutions.

Korean economy to contract sharply in 1980.

The deep recession that has hit the Korean economy this year is showing only a few signs of ending and will likely continue through the first half of 1980. Yearend 1980 data is expected to show a GDP decline of 5%-6%, a current-account deficit of some $5.3 billion, and consumer price inflation of more than 30%. The authorities have undertaken reflationary measures—including reducing interest rates—to ease the financial strains on business and limit unemployment. And the won exchange rate has been allowed to depreciate to enhance export competitiveness. In addition, energy prices have been raised to limit domestic oil consumption. The recent signals of economic improvement include a slight decline in producer inventories and a revival of export orders. Export letter-of-credit arrivals in September and October were up 47% above their level in the comparable 1979 period.

New Corporate Bond Issues Decline

The volume of new corporate bond offerings dropped sharply in November, totaling only $0.9 billion, or $1½ billion less than in October. This pace is a far cry from the activity at midyear, when offerings were in the $5-$6 billion range. Indeed, the November total represents the smallest dollar volume of new corporate issues in any month since September 1973. In this environment, there is increased market apprehension that the greater reliance on short-term debt has heightened borrower sensitivity to near-term swings in interest rates.

The recent declines in long-term financing reflect the unwillingness of firms to assume long-term debt at borrowing costs near record levels in a highly volatile and uncertain market. They also reflect an inability to tap sources of long-term credit for sizable amounts of funds at current rates.

Over the course of 1980, changes in the volume of new bond issues have been quite sensitive to changes in long-term interest rates. Corporations responded to the substantial decline in bond rates earlier this spring by bringing a record volume of new bond issues to the market. For example, May's increase of $3.3 billion over April (to a volume of $6.4 billion) corresponded to almost a 75-basis point decline in Aa utility rates—from roughly 12¾% to about 12%. And the recent decline in new bond issues has been in response to the run-up in rates of the last few months.

The recent drop in corporate bond offerings has been more than made up for by increases in short-term business credit. For example, during the first three weeks in November, business loans at large banks surged by almost $3½ billion and nonfinancial commercial paper rose by almost $900 million. This rapid increase in short-term credit demand has contributed to the recent upward pressure on money-market rates.

Corporate funding patterns during 1980 indicate just how sensitive the composition of corporate debt is to changes in interest rates. This has implications for the behavior of various credit measures as well influencing whether the increasing reliance of corporations on short-term debt will continue.

If bond market conditions improve dramatically in the near term and long-term rates fall, then the volume of new corporate bond issues will probably jump to levels similar to those of mid-1980. This in turn would lead to a sharp reduction in the growth of bank loans and commercial paper.

If, however, conditions in the bond market remain unfavorable much longer, the market's fears that certain corporations will become too heavily burdened with short-term debt may be substantiated.

A New Slump in Consumer Spending?

In the face of rising interest rates that are pushing last spring's heady levels, concern about the specter of a new downturn in the U.S. economy is high. So far, there are ominous signals that the economy is indeed slowing down in response to higher interest rates. Sales of new and existing homes have fallen off again after a sharp recovery over the summer, auto sales have failed to improve as expected with the introduction of the 1981 models, and building permits for residential construction declined 15% in October, foreshadowing further weakness ahead. But most important is the outlook for consumer spending, which accounts for roughly two-thirds of GNP. If a renewed recession develops, a turndown in consumption expenditure will almost surely lead the way. And the determinants of consumer spending do seem to suggest a downturn.

The unanticipated acceleration of inflation, partly the result of higher energy prices, and the progressive income tax structure have actually kept real disposable personal income from growing for nearly two years. But throughout 1979 and early 1980, consumers supplemented their shrinking real incomes by borrowing heavily to augment their buying power. Consumer credit as a source of strength faltered in March 1980, however. Interest rates had soared to levels that made lending to consumers unprofitable (especially where usury ceilings were activated), and the Federal Reserve's implementation of controls on the issuance of consumer and other forms of credit sent retail sales reeling. Net liquidation of consumer instalment debt in the spring eliminated $35 billion from consumers' purchasing capacity (at an annual rate) in contrast to net accumulation of debt of $40 billion a year earlier.

Interest rates fell sharply and the credit controls ended early in the summer. Consumers were once again willing and able to borrow more freely, although at a sharply lower rate than in the first quarter of 1980. Consumer spending was further bolstered as Social Security beneficiaries' incomes received an $18-billion boost in July. Mirroring these developments, retail sales increased at a 23% annual rate in the June-September period.

With real disposable income failing to show any growth since July and interest rates again at levels that discourage consumer lending, however, it is hardly surprising that consumption is beginning to stagnate—as suggested by the 0.1% decline in retail sales in October. And consumer buying power will suffer further beginning January 1, 1981 when the payroll tax for Social Security rises 0.5%. Thus, forces are in place to bring about a new slump in consumer spending, even if credit controls are not reimposed and interest rates remain stable. A sizable tax cut in mid-1981 would thus be necessary to trigger a renewed, extended upsurge in consumer spending, and consequently, a sustained economic recovery.

Asia and Oceania Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1979		BALANCE OF PAYMENTS						MONEY AND BANKING							COUNTRIES
		6 months ending	12-month change	In billions of dollars	per capita	latest data	reserves (less gold) in millions $	12-month change	months of imports covered	use of IMF credit, millions of dollars	current influences on payments	12-month changes: latest data	consumer prices	latest data	money supply(M1)	exchange rate in U.S. dollars December 3, 1980	change from year earlier	current monetary conditions	
Bangladesh	Agricultural prospects favorable, with record food storage expected.	June	+ 15%	9.9	$ 116	Oct.	185	— 56%	0.9	167	Rice exported and cheaper wheat imported to earn foreign exchange.	June	+12%	July	+16%	.0700	+14%	Bank rate and interest rate on deposits raised.	Bangladesh
Burma	Policy of running government-owned enterprises on commercial basis yields positive results.	July	+ 17%	5.0	154	Oct.	240	+ 26%	8.6	60	Oil self-sufficiency and rising exports improve trade balance.	Aug.	+ 1%	Sept. 79	+14%	.1565	+ 2%	Inflation rate under 10%.	Burma
China, People's Republic	Smaller grain harvest will restrain economic growth over the next 12 months.	June	+ 45%	515.0	510	Mar.	1,918	— 25%	1.4	0	Petroleum exports to Japan to fall short of commitments.	n.a.	—	—	—	.6800	0	IMF boosts Fund quota to SDR 1.2 billion.	China, People's Republic
Hong Kong	Property and stock market boom continue, although exports are down.	Aug.	+ 30%	17.6	3,320	n.a.	—	—	—	—	Recent tourism upswing helps narrow current-account deficit.	Sept.	+14%	Aug.	+31%	.1958	— 3%	High interest rates beginning to bite.	Hong Kong
India	Industrial output growth rising in second half of fiscal 1980/81.	June	— 24%	126.3	194	July	6,764	— 8%	7.0	343	Foreign-investment policy concessions made to attract petrodollars.	Aug.	+10%	May	+10%	.1275	+ 3%	More flexible exchange-rate policy adopted.	India
Indonesia	Oil exploration spending surges, with new leases granted; oil output expected to rise.	Feb.	+ 50%	47.1	317	Oct.	6,101	+ 61%	8.4	0	Exchange rate stable despite large payments surplus and rising reserves.	Sept.	+15%	July	+50%	.001610	+ 1%	Budget for FY 1981/82 is expansionary.	Indonesia
Japan	Domestic demand continues extremely sluggish.	Aug.	+ 26%	1,011.0	8,725	Oct.	24,055	+ 7%	1.9	0	Curent account should approach balance in fourth quarter.	Aug.	+ 9%	Sept.	— 4%	.004680	+13%	Continued cautious easing of monetary policy.	Japan
Korea	Real GNP this year will decline by 5%-6%.	Aug.	+ 15%	60.1	1,598	Sept.	3,714	+ 33%	1.8	626	Exports show signs of recovery, led by heavy industry.	Sept.	+30%	Sept.	+21%	.001640	—21%	Credit eased to relieve ailing industries.	Korea
Malaysia	Rising real income supports boom in property and stock markets.	Mar.	+ 38%	19.4	1,457	Aug.	4,482	+ 17%	5.3	0	Surge in capital goods imports narrows trade surplus.	Sept.	+ 6%	July	+17%	.4550	— 1%	Interbank liquidity easing somewhat.	Malaysia
Pakistan	Prices raised to reduce subsidies and boost profitability of public-sector enterprises.	June	+ 32%	23.0	288	Oct.	404	+164%	1.1	308	Exports in July-September period rose 18% from previous year.	June	+11%	June	+17%	.1020	+ 1%	Three-year loan of $1.7 billion granted by IMF.	Pakistan
Philippines	Recession affects many industries, but several major new foreign investments reported.	May	+ 34%	29.4	617	Oct.	2,535	+ 21%	4.0	814	Reduced oil consumption, improved sugar exports moderate trade deficit.	Sept.	+14%	July	+13%	.1360	+ 1%	Tight fiscal management follows IMF guidelines.	Philippines
Singapore	High wage policy may be maintained through 1982.	July	+ 46%	8.9	3,790	July	6,210	+ 12%	3.2	0	Proposed industrial cooperation with PRC may lure multinational investment.	Sept.	+ 7%	June	+18%	.4757	+ 3%	High interest rates maintained.	Singapore
Sri Lanka	Taxes raised, prices boosted, and spending cut to reduce budget deficit.	June	+ 19%	3.3	226	May	401	— 6%	2.4	299	Investment promotion targeted more at specific countries and firms.	Aug.	+33%	May	+24%	.0580	—10%	New fiscal measures may ease credit growth.	Sri Lanka
Taiwan	Continuing stability and prosperity attract foreign (including European) banking interests.	Sept.	+ 23%	32.2	1,840	July	2,472	+ 24%	2.1	0	Small trade deficit will result from current export slump.	Aug.	+18%	Sept.	+17%	.0290	0	Government pursuing high-interest-rate policy.	Taiwan
Thailand	Increased agricultural output and reduced border tensions boost business confidence.	July	+ 31%	27.3	591	Oct.	1,808	— 1%	2.8	213	Trade deficit widening because of oil imports.	Sept.	+17%	June	+15%	.0510	+ 4%	High interest rates being maintained.	Thailand
Australia	Relatively conservative fiscal and monetary policies likely to continue with Fraser victory.	Sept.	+ 19%	119.1	8,259	Oct.	1,900	+ 31%	0.7	162	Pressures persist for reductions in tariff barriers.	June	+11%	Aug.	+12%	1.1645	+ 6%	Credit squeeze likely in first half of 1981.	Australia
New Zealand	Stimulative fiscal measures to take effect in early 1981.	Aug.	+ 16%	17.5	5,651	Oct.	546	— 19%	0.8	207	France blocking agreement concerning 1981 butter exports to EEC.	June	+18%	Aug.	+15%	.9565	— 3%	Trading-bank lending 13% ahead of year-ago level.	New Zealand
Papua New Guinea	High rate of government spending causing concern as inflation rate doubles.	Jan.	+ 31%	1.8*	620	Oct.	499	— 18%	5.7	6	Aid from Australia to decline in real terms.	June	+13%	Sept.	+10%	1.5385	+ 9%	Exchange-rate revaluation policy coming under attack.	Papua New Guinea

*1978

World Interest Rates

market rates of Dec. 3, 1980; bond yields as of Nov. 28, 1980

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	12.00 penalty-lg. bks. 14.00	13.95	14.00	12.00	9.50	7.50	16.50 penalty rate 19.50	8.00	3.00	7.25
Day-to-Day Money	17.25 Dec. 4	13.25	13.75*	8.65	10.875	9.10	17.625	9.25	4.50	9.625
Treasury Bills 91-day, Middle Rates	14.60	14.30	13.375*	12.75	n. a.	n. a.	15.699 87-day	no dealing	no market	5.875 2-month
Commercial Paper prime, 3-month, asked	14.25 finance paper	14.50 finance paper 15% tax w/h	12.85*	11.60 Certified	11.625 interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	16.85	14.50 15% tax w/h	13.6875*	11.60 Certified	not traded	9.90	20.70	no market	4.50	no market
Government Bonds Long-term, new and old issues, average yield	12.30	13.40	13.17	10.678 20% tax w/h	13.68	8.76	16.18	10.37	4.68	9.031
Industrial Bonds prime, long-term, new and old issues, average yield	12.85 Aa Industrials	13.90	13.63	13.564	14.69	8.97	16.28	11.24	5.59	7.27
Bank Short-Term Rate to Best Borrowers (prime rate)	18.50	15.00	15.00*	15.75	13.85	11.50	21.00 ⅛ quar'ly fee on outstdng.	11.00	5.50	7.50
Bank Time Deposits 3-month	16.875 Cert. of Dep.	13.00	15.4375*	13.00	11.6875	9.75	10.75	9.875 large deposits	6.00 residents only	5.00 20% tax w/h
Eurocurrencies 3-month, asked	18.0625	no market	14.875	no market	11.75	9.75	no market	9.875	6.00	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8370	2.3480	.0320	.2219	.5148	.001084	.4752	.5703	.004680
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	3.625 *P*	3.00 *P*	4.75 *P*	6.00 *P*	7.875 *P*	FLAT	7.75 *P*	11.625 *P*	6.75 *P*

Eurodollar Deposits
(London, interbank, bid)
Dec. 4

7-day	18.3125
1-month	18.875
3-month	18.50
6-month	16.875

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	n.a.
U.S.-Canada Treasury Bills	−2.67
U.S.-Canada Finance Co. Paper	−3.675
Eurodollars-U.K. Local Auth. Deposits	n.a.

Eurobonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	13.625
Over 7 yrs.	14.00
DM Bonds	
7 yrs. and under	9.20
Over 7 yrs.	9.375

Gold Price
London afternoon fixing
627.25
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
* Market rates as of Nov. 27.

Key Indian Economic Indicators

	FY*1977/78	1978/79	1979/80	1980/81**	1981/82**
Real GDP Growth, %	7.7	4.9	−3.0	6.0	3.6
Wholesale Price Inflation, %	5.2	0	16.7	13.0	12.0
M_2 Growth, %	20.3	21.5	17.3	16.0	15.0
Trade Balance (million $)	−715	−1,297	−2,800	−4,800	−5,500
Current-Account Balance (million $)	807	500	−750	−2,600	−3,300
Reserves/Average Monthly Imports	9.4	10.1	8.4	6.5	5.4
Exchange Rate (rupees per U.S. $)	8.563	8.206	8.076	7.8	8.0

* Fiscal year runs April through March
** Estimated

Capacity Constraints Limit India's Growth

India's $126-billion economy is characterized by heavy dependence on imported oil, widespread infrastructural bottlenecks, and an agricultural performance that remains highly dependent on the weather. Consequently, real GDP declined by about 3% in fiscal 1979/80 (ended in March 1980) in the wake of a doubling of oil import costs and a severe drought that depressed agricultural output and aggravated energy supply bottlenecks. The government of Indira Gandhi has responded to the poor economic showing by enacting measures aimed at alleviating the infrastructural bottlenecks, reducing dependence on imported oil, and dampening the recent surge in inflationary pressures. Economic propsects for fiscal 1980/81 and thereafter will depend to a large degree on the success of these measures and the government's determination to see them through.

Domestic economy rebounding

India's poor economic showing last fiscal year was in sharp contrast to the real economic growth rate of nearly 5% achieved in fiscal 1978/79 and the 7.7% posted in FY 1977/78. The major causes were a 10% drop in agricultural output triggered by the drought and a stagnant industrial performance attributable to political uncertainty, labor unrest, and power and transport bottlenecks.

A return to positive real economic growth is envisaged for the current fiscal year; indeed the country's sixth five-year plan—including fiscal 1980/81 and running through 1984/85—has targeted an average annual real economic growth rate of 5.2%, with annual growth of 4% in agriculture and 8%-9% in industry. To achieve such results, the authorities plan to emphasize the development of agriculture, power, transport, domestic energy sources, and job creation.

India's 1980/81 budget underscores the new approach by boosting public spending on oil exploration by almost 35% and increasing investment in the state-owned coal and steel industries by 33% (although public investment in electric power will rise by only 11%). Resources have been allocated to improve rail transport, and the government is committed to enhancing management efficiency in key state industries. In the agricultural area, the authorities are likely to sustain their efforts to increase irrigation, introduce higher-yield seeds, and expand fertilizer use. Finally, to spur sluggish private investment in industry, the government has relaxed licensing restrictions to allow private productive capacity to expand. It has also moved to permit increased foreign technological collaboration and has adopted various fiscal incentives.

Real GDP growth in the current fiscal year is projected at 6%—a sharp rebound from the negative growth in fiscal 1979/80. Plentiful rainfall—still the lynchpin of agricultural performance—will permit agricultural growth of 10%-11%. Although the public-sector enterprises are performing more strongly than last year, industrial production has remained stagnant as a result of persistent bottlenecks, reduced agricultural incomes brought on by last year's drought, and the worldwide economic slowdown. The abundant rainfall this year has alleviated the infrastructural bottlenecks somewhat by boosting the supply of hydroelectric power. But the main problem is one of inadequate infrastructural capacity, which will limit industry's growth rate to 3%-4% in 1980/81 and constrain output over the medium term.

Looking out to fiscal 1981/82, the agricultural growth rate is expected to return to a more normal 2.5%-3%, assuming favorable weather. If infrastructural bottlenecks continue to ease and the official policies succeed in spurring private-sector enterprise, a 6%-8% growth in industrial output is possible. With these assumptions, GDP growth would be about 3.6% in fiscal 1981/82, suggesting that the government's five-year plan targets are rather optimistic.

Inflationary pressures reemerging

Last fiscal year marked the end of a period of relatively low inflation. Wholesale prices in fiscal 1979/80 increased by an average of 16.7%, after nearly zero wholesale price inflation in 1978/79. The resurgence of inflation was caused by an excess supply of money. The government budget deficit ballooned in fiscal 1979/80 because of a drought-induced spurt in government spending and reduced revenues associated with a weak economy. As a result, the rate of money supply (M_2) growth—which had been 20% in each of the two previous years—only fell to about 17%. At the same time, the demand for real money balances declined sharply in response to falling real income, and the resulting excess supply of money put upward pressure on prices. A large rise in the price of traded goods, particularly of imported petroleum products, added to the upward pressure.

Although planned reductions in government subsidies will exert upward pressure on prices in 1980/81, such cuts should improve the longer-term outlook for inflation by reducing the budget deficit and permitting a lower rate of domestic credit expansion. If money supply growth approximates its 1979/80 pace in the current fiscal year, and the demand for real money balances picks up as real income climbs, the rate of wholesale price inflation may drop to about 13% in 1980/81. Further significant moderation in in-

flation appears unlikely in fiscal 1981/82.

External-payments balance deteriorating

India's trade balance worsened considerably last year. The country's trade deficit widened from $1.3 billion in fiscal 1978/79 to $2.8 billion in FY 1979/80. Export volume fell slightly, owing mainly to the weak domestic economic showing and labor problems, but also because of the de-emphasis of exports by previous governments. Import volume growth was moderate, reflecting depressed domestic income and caution in the implementation of the government's more liberal import policy. In value terms, exports rose only 8% last fiscal year, while imports jumped nearly 25%. The higher import bill reflected higher prices for all major imports, but was primarily the product of sharply higher oil and fertilizer import costs. Compounding the problem was the prolonged political agitation in Assam, one of India's three major oil-producing areas, which halted production and further increased India's oil import requirements. Consequently, the petroleum import bill more than doubled to $4.75 billion. Heavy inflows in the form of workers' remittances from abroad offset the trade shortfall only partially, leaving India with a current-account deficit of $750 million, a sharp reversal from the $500-million surplus in fiscal 1978/79.

The deteriorating external-payments situation has also manifested itself in an alarming decline in India's international reserves since the beginning of 1980. To address the problem, the Gandhi government has taken steps to foster export-oriented activity. It is also seeking to step up domestic oil production by inviting foreign firms to participate in exploration and development. And it is attempting to reduce the oil import bill by obtaining concessional terms from OPEC members. In other efforts to improve its balance of payments, India is acting to boost oilseed output, spur the production of such products as cement and steel (currently imported in large quantities), encourage Indians abroad to transfer home larger earnings, and solicit direct investment from OPEC. India's liberalized import policy, which is aimed at enabling industry to obtain needed inputs, will continue, but imports deemed unnecessary (such as consumer goods) will likely continue to be restricted.

Despite these initiatives, India's payments balance will probably deteriorate further in fiscal 1980/81 and again in 1981/82. Persistent power shortages, transport bottlenecks, and growing domestic demand for commodities, together with the worldwide economic slowdown, are likely to depress sales abroad. Total exports are thus expected to increase by 10%, at best, in 1980/81. Imports of such products as steel and cement should decline as domestic production picks up, and non-oil imports will likely be restrained because of balance-of-payments pressures. But total import costs will still rise by 25% or more, largely because of higher-priced oil. Iran and Iraq together had satisfied nearly two-thirds of India's oil import needs before the outbreak of war in the Mideast, and with the disruption in oil supplies, these needs must now be met at least in part through higher-priced spot-market purchases. As a result, India's oil import bill could approach $7 billion in 1980/81. Thus a trade deficit of some $4.8 billion is projected for 1980/81, with the current-account gap likely to widen to $2.6 billion.

If the government's efforts to stimulate exports are maintained in 1981/82, and infrastructural deficiencies are partly alleviated, exports could grow by 12%-14%. But even with a slowdown in import growth, India will still likely face a trade deficit of more than $5 billion and a current-account gap of over $3 billion in fiscal 1981/82.

The prospect of rapid external-account worsening is especially disturbing at a time when net foreign aid disbursements are falling off. External aid was sufficient to finance the 1979/80 current-account gap, even permitting total reserves to rise somewhat. But the deficits anticipated for the next few years will likely exceed net aid disbursements, given the unfavorable aid climate. Unless imports are cut back substantially or aid commitments boosted sharply, India may have to seek increased IMF funds (to supplement the $1.04 billion recently provided through the IMF's Compensatory Financing and Trust Fund facilities) or turn to the world capital markets to avoid a large loss of international reserves. Even so, India's reserves are expected to decline to less than six months of import cover by the end of fiscal 1981/82.

Although India's problems are serious, the Gandhi government has demonstrated that it has the power and the will to adopt the needed corrective policies. The crucial question is whether Indira Gandhi will be able to maintain her current mandate—which is reflected by a two-thirds majority in parliament—and quell internal unrest to prevent any major disruption of the economy. Furthermore, given India's history of dramatic reversals in policy, the Indian authorities will also have to convince private business that the current policies will be sustained. *Melanie L. Lau*